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July 22, 2011

Board of Governors of the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington DC 20551
Attn: Jennifer J. Johnson, Secretary

Re: Comments on Proposed Rule, Docket No. R-1417 (Regulation Z; Truth in Lending)

Ladies and Gentlemen:

Fannie Mae is pleased to submit these comments regarding the Board of Governors' proposed amendments to Regulation Z (Truth in Lending, 12 C.F.R. § 226) to implement the Ability to Repay provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Fannie Mae has invested significant resources over the past several years to improve the quality of the loans it acquires. Quality loans -- those that are prudently underwritten with accurate information -- have a greater likelihood of success over the long term and perform better across all market cycles, not just in times of rising home prices.

The requirements embedded in the Board's proposal align with most of Fannie Mae's efforts to improve loan quality. Where there are deviations, the differences tend to be relatively minor. As a result, our letter addresses some of the more significant policy issues the Board specifically requested comment on, and provides data on particular issues for the Consumer Financial Protection Bureau (CFPB) to consider when drafting the final rule. Our comments address the following sections of the Board's proposal: § 226.43(c) regarding the repayment ability requirements; § 226.43(d) regarding the requirements for certain refinance transactions; and § 226.43(e) regarding qualified mortgages, including the challenges posed by a rebuttable presumption and limits on points and fees for qualified mortgages.

I. Repayment Ability - § 226.43(c)

The Dodd-Frank Act requires creditors to make a determination that a consumer has the ability to repay a loan before the loan is consummated. Proposed § 226.43(c) sets forth the requirements a creditor must meet in determining whether a consumer has an ability to repay the loan. While the regulation requires creditors to consider these factors and provides some

guidance, it does not prescribe, for example, a maximum debt-to-income ratio.¹ Fannie Mae has several observations and suggestions to improve clarity yet maintain access to credit for consumers. These relate to: (i) use of automated underwriting systems; (ii) treatment of debt obligations expiring in 10 months or less, (iii) consideration of deferred obligations; and (iv) treatment of undrawn amounts on home equity lines of credit (HELOCs).

A. “Widely accepted underwriting standards” should specifically include the automated form of those standards

The Board’s proposed comment 1 to § 226.43(c) allows creditors to look to “widely accepted governmental and non-governmental underwriting standards” to evaluate a consumer’s ability to repay, referring to the Federal Housing Administration’s (FHA) handbook as one example. While some lenders rely on written guides, many more rely on the automated expression of such materials found in automated underwriting systems such as Fannie Mae’s Desktop Underwriter® (DU®) and FHA’s TOTAL Mortgage Scorecard. Fannie Mae requests that the comment be expanded to make clear that a creditor may rely not only on the written versions of underwriting standards, but also on the automated versions.

B. Fannie Mae supports the Board’s approach to “current debt obligations,” including simultaneous loans

To meet the requirements of § 226.43(c), a creditor must consider a consumer’s current debt obligations to determine a consumer’s ability to repay the loan. Current debt obligations include HELOCs, whether entered into simultaneously with the closing of the first lien or resubordinated as part of a refinancing of the first lien.

Obligations that Expire in 10 Months or Less. The Board has asked whether it should provide guidance on debts that will pay off in 10 months or less. The Board directs creditors to look to widely accepted governmental and non-governmental underwriting standards to define current debt obligations, therefore, Fannie Mae would like to provide some information regarding our experience. Fannie Mae has found that installment debts, alimony, child support, separate maintenance payments and other obligations with a definitive end date of 10 months or less do not have a material impact on a consumer’s performance and may be disregarded unless the consumer will have limited cash assets after closing. FHA has a similar policy and it is our understanding that this 10 month approach is a fairly common underwriting standard.

Projected Obligations. The Board has solicited comment on whether obligations in forbearance or deferral should be taken into account in determining a consumer’s current debt obligations. As a general rule, Fannie Mae requires that all obligations, even those in forbearance or deferral, be taken into account in underwriting a loan. The only exception relates to “community second” loans which generally provide for debt forgiveness or shared appreciation upon sale of the

¹ As a consequence, it is possible that a creditor could consider all of the required factors, but still be found to have violated the ability to repay requirement if, for example, the credit history showed significant delinquencies or the debt-to-income ratio was unusually high with insufficient any compensating factors.

property. Fannie Mae permits creditors to disregard these obligations when calculating repayment ability. Fannie Mae encourages the CFPB to provide similar guidance with respect to “community second” loans.

Undrawn Amounts on Simultaneous HELOC Loans. The Board requested comments on its proposal requiring creditors to consider only the portion of a HELOC to be drawn at loan closing, instead of the full line of credit. Fannie Mae’s requirements track the Board’s proposal. If creditors must use an overstated HELOC amount, consumers may delay opening a HELOC until the first lien is closed, with the result that none of the HELOC payments will be taken into account. Assessing more debt upon the consumer than he or she actually has at the time of underwriting may unnecessarily disqualify creditworthy consumers and have unintended consequences, such as leaving the assignee in a less secure position than it would otherwise be in.

While Fannie Mae uses only the actual amount drawn for the HELOC in order to calculate debt, we require that the entire amount of the HELOC be considered for purposes of calculating the LTV/CLTV/HCLTV of the loan. If consumers were unintentionally encouraged to take out HELOCs after the primary loan closes instead of simultaneously, originators would not have information about the HELOC to consider as part of the underwriting and investors would not know the true LTV/CLTV/HCLTV on the loans it is purchasing. Furthermore, using the actual amount to be drawn on the HELOC is consistent with the treatment of other revolving credit, such as credit cards. Fannie Mae urges the CFPB to treat all revolving credit in a consistent manner, which would allow consumers more access to credit, increase the simplicity of debt-to-ratio (DTI) calculations and would encourage consumers to engage in an honest exchange of financial information with creditors.

II. Refinance of Non-Standard Mortgages - § 226.43(d)

Proposed § 226.43(d) implements the provisions of the Dodd-Frank Act that address conventional refinance transactions. These provisions are designed to promote refinances that would benefit borrowers by placing them in more stable loan products and lowering their payments. In order to promote these transactions, creditors would not have to consider and document a consumer’s income and assets if the loan meets certain requirements.

Streamline refinance transactions are an important risk management tool for Fannie Mae and can reduce overall credit risk by putting consumers into loans that are more sustainable. Consumers benefit from a simplified application process which results in a lower monthly payment. Fannie Mae appreciates the work that the Board has done in trying to faithfully interpret the Dodd-Frank Act’s provisions, but as proposed the regulation will prevent a significant number of creditworthy borrowers from obtaining streamline refinances. Fannie Mae requests, therefore, that the CFPB consider using its discretionary power to enable more consumers to take advantage of streamline refinances by expanding the population of eligible loans and lowering the threshold for what is deemed a material reduction in monthly payments.

A. The definition of “non-standard mortgages” is too narrow and precludes most consumers from obtaining lower cost refinances

Under proposed § 226.43(d)(2)(i), only “non-standard mortgages” would be eligible for the streamline refinance provisions. Consumers with fixed rate, fully amortizing loans and balloon loans could not benefit from these provisions, even if they are at risk of default. As a result, these consumers would be barred from quicker, lower cost refinance transactions.

Of the more than 1.2 million streamline refinances Fannie Mae has acquired between April 2009 and May 2011, only 8.25% (approximately 100,000 loans) would have been eligible under the Board’s proposal. Although congressional intent was to assist consumers with riskier mortgage products, Congress did not put the same product limitations on government loans. The Department of Housing and Urban Development, the Department of Veterans Affairs, the Department of Agriculture, and the Rural Housing Service all have authority under the Dodd-Frank Act to exempt streamlined refinances from the income and asset verification requirement without regard to the original mortgage product.

As a result, consumers with fixed rate and balloon conventional loans may have to pay more to refinance their mortgages because of additional documentation requirements. They will also have to go through a longer, more cumbersome process to qualify for a new loan than consumers with government loans. It is hard to imagine what public policy would be served by allowing borrowers under government programs to benefit from streamline refinance transactions, but not borrowers of conventional loans.

Fannie Mae respectfully suggests that the CFPB use its discretionary powers under Sections 129B(e) and 105(a) of the Truth in Lending Act to broaden the definition of “non-standard mortgage” in § 226.43(d)(2)(i) to include fixed rate fully amortizing loans and balloon loans so that consumers with conventional loans can benefit from the streamline refinance provisions.

We believe this approach is consistent with the statements of the co-author of the Dodd-Frank Act. In a colloquy, Senator Dodd stated:

However, certain refinance loans, such as VA-guaranteed mortgages refinanced under the VA Interest Rate Reduction Loan Program or the FHA streamlined refinance program, which are rate-term refinance loans and are not cash-out refinances, may be made without fully reunderwriting the borrower, subject to certain protections laid out in the legislation, while still remaining qualified mortgages.

It is the conferees’ intent that the Federal Reserve Board and the CFPB use their rulemaking authority under the enumerated consumer statutes and this legislation to extend this same benefit for conventional streamlined refinance programs where the party making the new loan already owns the

credit risk. This will enable current homeowners to take advantage of current low interest rates to refinance their mortgages.

156 Cong. Rec. 5928 (July 15, 2010).

Finally, we note that Fannie Mae's streamline refinance program has many of the same requirements that the Dodd-Frank Act applies to streamline refinance programs for government insured or guaranteed loans. Eligibility for a Fannie Mae streamline refinance requires, among other things, the following: (i) the consumer must be current on the existing loan and cannot have had more than one 30-day delinquency on such mortgage within the prior 12 months; (ii) the new principal balance cannot exceed the aggregate of: (A) the balance on the existing loan, (B) financed closing costs, and (C) up to \$250 in cash back to the borrower; (iii) the consumer must receive a benefit in the form of lower monthly payment of principal and interest, a shortened amortization term or movement to a more stable loan product; and (iv) the new loan must be fully amortizing, with no balloon payments. Although Fannie Mae cannot cap total points and fees a creditor may charge for a streamline refinance transaction, Fannie Mae has capped its own loan level price adjustments at 2% in an effort to reduce consumers' costs. Given these similarities, it would be appropriate for the CFPB to use its rulemaking authority to ensure that conventional streamline refinance programs are on par with government programs when the party who already owns the risk acquires the refinance loan.

B. The proposed safe harbor for "material reduction in monthly payment" is too high

For an existing loan to be eligible for a streamline refinance, the monthly payment on the new loan must be "materially lower" than the payment on the existing loan. The Board has solicited comment on its proposal that a 10% reduction in the monthly principal and interest payment would be deemed a material reduction. After reviewing our streamline refinance program, Fannie Mae suggests that the CFPB consider a 5% reduction to be material, rather than the proposed 10%.

Fewer than two-thirds of all the streamline refinances that Fannie Mae acquired between April 2009 and May 2011 would have met a 10% test.² If the test were reduced to require a 5% change in borrower's payment, the number of Fannie Mae streamline refinances that would qualify would instantly increase to three-quarters.

Although the proposal states that the determination of whether the new loan payment is materially lower depends on the facts and circumstances of the case, creditors will undoubtedly use whatever number the CFPB selects as the floor. A small adjustment to the percentage change of what constitutes "materially lower" (10% to 5%) helps many more borrowers qualify

² Fannie Mae's data is based upon a comparison of the consumer's monthly payment before and after the streamline refinance. Fannie Mae is unable to estimate what a consumer's monthly payment would have been following the recast event. As a result, Fannie Mae cannot entirely replicate the Board's proposal.

for streamline refinances. Fannie Mae suggests that the CFPB adopt 5% as the safe harbor for meeting the materially lower requirement.

III. Qualified Mortgages -- § 226.43(e)

A creditor must determine a consumer's reasonable ability to repay before consummating a loan; consumers may raise a creditor's failure to determine ability to repay as a defense to foreclosure. Congress intended to promote the origination of stable loan products with limited points and fees (*i.e.*, qualified mortgages) by providing creditors and assignees with a measure of relief from legal claims that a creditor failed comply with the ability to repay requirements. Proposed § 226.43(e) implements the qualified mortgage provision of the Dodd-Frank Act.

The Board's proposal generally states that if a creditor originates a qualified mortgage, the creditor or assignee would receive some degree of protection from legal liability. Fannie Mae addresses three issues regarding qualified mortgages below: (i) challenges of a rebuttable presumption for assignees; (ii) treatment of loan level price adjustments (LLPAs) as bona fide third party fees; and (iii) clarification as to when new fees are cannot be considered part of an already consummated transaction.

A. A Rebuttable Presumption presents challenges for an assignee

The qualified mortgage provisions in the Dodd-Frank Act uses both of the terms, "safe harbor" and "rebuttable presumption" to refer to the type of legal protection a qualified mortgage might afford. As a result, the Board opted to solicit comment on two regulatory alternatives, only one of which will be adopted. A fundamental difference between the two alternatives is the potential scope of the review into how the loan was originated.

Under the safe harbor, if a consumer raises the ability to repay as a defense to foreclosure, a court would evaluate whether a loan met the qualified mortgage product parameters (*e.g.*, did the loan have an IO feature) and whether the creditor adhered to specified underwriting procedures (*e.g.*, were income and assets considered and verified). Absent a showing that product parameters or underwriting procedures were not followed, a court would not examine the considerations behind the underwriting decision or the reasonableness of the creditor's judgment. Under a rebuttable presumption, a court would look not only to whether product parameters and underwriting procedures were met, it could also re-examine the reasonableness of the creditor's underwriting judgment and decide, for instance, that a consumer's debt to income ratio was too high in light of the consumer's information.

Determining a consumer's ability to repay is of paramount importance. Not only does the law require an ability to repay determination, it is the hallmark of sound underwriting practices. Indeed, to be eligible for sale to Fannie Mae, every loan will have to meet Fannie Mae requirements that embody the ability to repay standard. Simply meeting the qualified mortgage requirements will not be enough.

That being said, Fannie Mae will do all it can to avail itself of the qualified mortgage protection whenever it is possible and in whichever form it takes. The rebuttable presumption, however, will present challenges since Fannie Mae is not part of the origination process. When acquiring a loan, it simply is not feasible for Fannie Mae to evaluate all of the considerations that went into an underwriting decision and must rely on the creditor's representations that the loan was originated in compliance with applicable laws and our requirements.

And yet, Fannie Mae, as assignee, may find itself having to defend a creditor's underwriting decision at any time during the life of the loan because there is no statute of limitations on raising the failure to make an ability to repay determination as a defense to foreclosure. Defending such decisions can be both difficult and costly because while Fannie Mae may have some or all of a loan file, it will not be able to know all of the considerations and compensating factors that influenced the originator's decision to make the loan.

Because the rebuttable presumption standard will involve not only verifying that objective steps were taken, but also that appropriate subjective judgments were made, assignees will find the standard a significant and costly hurdle in litigation. A rebuttable presumption increases liability for assignees like Fannie Mae and necessitates litigation involving a subsequent and inherently subjective inquiry about a consumer's ability to repay. The legal certainty to avoid having one's judgment second-guessed in exchange for limiting fees and loan product features is the result Fannie Mae believes Congress envisioned.

Criteria for qualified mortgages should not absolve originators from their duties to see that borrowers have the ability to repay. Processes, procedures and requirements to detail originator activity and compliance on which secondary market parties may rely should be central to the regulation. If the definition of qualified mortgage necessitates a robust and complete underwriting process, consumers, creditors and assignees should have a reasonable degree of confidence that qualified mortgages will reflect the consumer's ability to repay.

B. Loan Level Price Adjustments should be excluded from points and fees test for Qualified Mortgages and Refinance Mortgages

The Board has proposed that points and fees cannot exceed 3% of the "total loan amount" for streamline refinance transactions (§ 226.43(d)) and qualified mortgages (§ 226.43(e)).³ Section 226.43 relies on the definition of points and fees for high cost loans found in § 226.32, the definition of which is being expanded to include, among other amounts, "all compensation paid directly or indirectly by a consumer or a creditor to a loan originator." However, in determining whether a qualified mortgage or refinancing has met the 3% points and fees test, § 226.43 provides for two exclusions that do not apply to high cost loans. Creditors may exclude: (i) up to two bona fide discount points under certain circumstances; and (ii) any third party fees not retained by the creditor, loan originator or an affiliate.

³ The 3% applies to loans of \$75,000 or more; for loans under \$75,000, the allowable points and fees would be higher. The exact amount will depend on which of the two proposed alternatives is adopted.

In the proposal, the Board discusses loan level price adjustments (LLPAs) charged by Fannie Mae and Freddie Mac (the GSEs) which are designed to compensate for different risk profiles such as credit score and loan-to-value ratio. The Board appears to believe these charges are similar to discount points and expresses concern about whether LLPAs should be excluded from the points and fees test, citing both Congressional intent that discount points be included in the test, and potential disadvantage for portfolio creditors if such fees were excluded. We believe that LLPAs should be excluded from the points and fees test.

Fannie Mae charges creditors LLPAs to compensate for incremental risk on loans with certain characteristics. LLPAs are set fees, charged across the board to all lenders on all loans with the salient characteristics. The fees are transparent and readily accessible via the GSEs' Web sites.⁴ Although lenders must pay LLPAs to the GSEs in cash at the time a loan is delivered, a lender, in its sole discretion, decides whether to recoup this expense from the consumer, and if so how -- through an increase in the interest rate or as a fee charged at closing.

Strictly speaking, LLPAs do not meet the definition of a bona fide discount point as provided in § 226.43(e)(3)(iv) because they are not amounts paid by the consumer to buy down the interest rate. LLPAs do, however, meet the definition of a third party fee as defined in § 226.43(e)(3)(ii)(A). They are "bona fide third party charges not retained by the creditor, loan originator, or an affiliate of either." Although Fannie Mae and Freddie Mac each have their own unique pricing matrices, the fees are based on objective loan-related criteria, and are universally applied to all loans with the same characteristics. Because the GSEs make the amounts and parameters publicly available, LLPAs are more transparent and less susceptible to abuse or upcharging than many other third party fees that can be excluded under the proposal. The Board noted that in outreach, creditors suggested LLPAs should be considered third party charges. We agree that third party charges are the appropriate legal characterization for the fees under § 226.43.

Given that the GSEs' pricing may increase, and would do so under regulator scrutiny, LLPAs should be excluded from the points and fees test. If they are not, the allowable points and fees will quickly be consumed by the combination of loan originator compensation and the GSEs' rising risk premiums. The result will render useless both the qualified mortgage exception and the refinancing provisions in § 226.43. We therefore request that the CFPB clarify, through regulatory language or commentary, that loan level risk adjustments which are uniform and transparent are excluded from the points and fees test under § 226.43.

We recognize the Board's concern that excluding LLPAs might create an unlevel playing field for portfolio lenders. Portfolio lenders have an advantage over the GSEs because they have the ability to directly affect the interest rate, and on a loan-by-loan basis adjust the pricing between rate and fees. The GSEs do not have that ability since they do not set the interest rate and have no control over how an originator divides up the costs associated with a loan. If the CFPB

⁴For Fannie Mae: <https://www.efanniemae.com/sf/refmaterials/llpa/>

wanted to create some parity, to the extent that portfolio lenders publish their loan level risk adjustments, these fees could be excluded from the test as well. This approach would have the added benefit of increasing transparency for consumers.

In addition, we request that the CFPB consider exempting LLPAs that are uniform and transparent from the definition of points and fees in § 226.32. With the lowering of the trigger to 5% for high cost loans under the Home Owners Equity Protection Act and the inclusion of loan originator compensation in the points and fees test, there is little room for LLPAs to increase before the trigger is hit. Fannie Mae does not purchase high cost loans because of the potentially abusive nature of these loans and the significant liability that attaches to them. In using its exemption authority, the CFPB could help foster the public policy goals of stabilizing the housing market and ensuring the availability of credit while still ensuring that consumers are protected from abusive lending.⁵

C. There must be a cut-off point after which fees can no longer be considered “incident to or a condition of” an extension of credit

Amendments made by the Dodd-Frank Act raise questions about whether and what fees paid after closing might be included in the points and fees test. As a result, the Board solicits comment on whether certain fees payable after closing that should be included in the points and fees test. As the Board rightly points out, including post-closing fees in the test creates a significant risk, particularly for assignees, that a loan which was originated within a points and fees tolerance will at some later date be found by a court to have exceeded the tolerance. The Board is correct in concluding that this could cause such a high level of uncertainty and risk of litigation that it would undermine any possible advantages that might be gained by originating a qualified mortgage or streamline refinancing.

Rather than a list of fees, which can change over time, Fannie Mae requests that the CFPB adopt commentary to provide guidance on when a closed-end mortgage loan transaction is concluded so that, as a matter of law, subsequent fees cannot be considered “incident to or a condition of” the extension of credit. Without such clarification, routine servicing fees or fees associated with a borrower’s request for a modification could potentially be swept into the test.

* * * *

⁵ For the reasons described above, LLPAs are more similar to § 226.32(b)(1)(3) fees that are excluded, than the excessive lender/broker compensation that the points and fees test was designed to address. It should be noted that LLPAs did not exist at the time § 226.32 was adopted so there is no regulatory or statutory guidance about how they should be treated. It is the confluence of the lower thresholds, more inclusive definition, and mandate to increase LLPAs that has caused us to raise this issue now.

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Fannie Mae very much appreciates the opportunity to provide the foregoing comments to the CFPB. If the CFPB has questions about our letter or would like further information regarding our comments, please feel free to contact Sheila Teimourian at 202-752-3096 or Sheilah Goodman at 202-752-6493.

Sincerely,

FANNIE MAE



Joseph J. Grassi, III
Senior Vice President &
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